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Nos. 725 - 726

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

RALPH R. ANDERSON,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

HERBERT R. ANDERSON,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

MATTHIAS CONCANNON,
WILLIAM H. DILLON,
BRUCE PARKHILL,
Counsel for Petitioners.

Schaffer Printing Company, Del. 7171

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PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioners, Ralph R. Anderson and Herbert R. Anderson, respectfully pray that writs of certiorari be issued to review the judgments (R. 139-146) of the Circuit Court of Appeals for the Seventh Circuit entered December 17,

1947, affirming the decisions of the Tax Court (R. 79-90, 100-102) sustaining deficiencies in income taxes for 1939 and 1940 aggregating $9,075.93 in the case of Ralph R. Anderson and $9,826.10 in the case of Herbert R. Anderson.

Opinions Below.

The opinion of the Tax Court (R. 79-89), affirmed below, is reported in 5 T. C. 443.

The opinion of the Circuit Court of Appeals (R. 139-145) is reported in 164 F. (2d) 870.

Jurisdiction.

The judgments of the Circuit Court of Appeals were entered December 17, 1947 (R. 145-146). Petition for rehearing was timely filed on December 31, 1947, and was denied on January 9, 1948 (R. 146, 147). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by Act of February 13, 1925, 26 Stat. 828, Ch. 517, § 6, as amended, 36 Stat. 1157, Ch. 231, § 240, 43 Stat. 938, Ch. 229, § 1, Title 28 U. S. C. A. § 347. This petition is timely filed in accordance with 26 Stat. 828, Ch. 517 § 6, as amended, 39 Stat. 727, Ch. 448, § 6, 43 Stat. 940, Ch. 229, § 8, Title 28 U. S. C. A. § 350.

Questions Presented.

(1) Whether petitioners (the donors) are taxable under Section 22 (a) of the Internal Revenue Code upon dividends paid upon and capital gains derived from the liquidation of shares of stock which theretofore had been transferred by them to members of their families by outright gifts, valid under state law;

(2) Whether a decree of a state court upholding the validity of such gifts, entered subsequent to the conflicting decision of the Tax Court upon the same question, is binding upon the federal courts and agencies, where the state court decree is brought to the attention of the Tax Court, and it is requested to consider and give effect to it, while that Court still has jurisdiction; and

(3) Whether a decision of the Tax Court, that petitioners are taxable upon such income on the ground that they had not made valid gifts of the stock, may be affirmed by the Circuit Court of Appeals upon the entirely different ground, not previously asserted, that petitioners are taxable under Section 22 (a) of the Internal Revenue Code, notwithstanding the validity of the gifts under state law, without remanding the case to the Tax Court and granting petitioners a hearing upon the new issue.

Statute Involved.

Sections 11 and 22 (a) of the Internal Revenue Code.

"SEC. 11. NORMAL TAX ON INDIVIDUALS

"There shall be levied, collected and paid for each taxable year upon the net income of every individual a * * * tax * * * " (Sec. 11, I.R.C., 53 Stat. 5.)

"SEC. 22. GROSS INCOME

"(a) GENERAL DEFINITION. 'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains

or profits and income derived from any source whatever. * * *" (Sec. 22 (a), I.R.C., 53 Stat. 9, 574)

Statement.

Petitioners filed their petitions in the Tax Court of the United States seeking redetermination of asserted deficiencies in income taxes for 1939 and 1940. The deficiencies for 1939 result from the inclusion in their income of dividends paid upon shares of stock of Robert R. Anderson Company which they had given to members of their families prior to the declaration of the dividends (R. 7, 20). The deficiencies for 1940 result from the inclusion in their income of capital gains realized upon liquidation of that company on the above mentioned and additional shares of stock in the company similarly given in 1940 (R. 7, 20). The cases were consolidated for hearing and after trial the Tax Court sustained the deficiencies (R. 90), holding in its finding of facts and opinion that bona fide gifts of stock had not been made by petitioners in 1937, 1938 and 1939 (R. 87, 88-89, 100-102). A motion for rehearing was granted in part and denied in part (R. 100-102).

Subsequently, petitioners filed a motion for special leave to file a motion seeking to have the Tax Court consider a decree of the Superior Court of Cook County, Illinois, which had determined that the gifts involved were bona fide and valid (R. 102-117). The Tax Court denied that motion (R. 118).

Upon appeal the Circuit Court of Appeals for the Seventh Circuit affirmed and a petition for rehearing was denied (R. 145, 146, 147).

The facts were found in detail by the Tax Court in its findings (R. 80-87), as later amended (R. 100-102). The

facts as so found are not challenged in any material respect, except the conclusion that no bona fide gifts of stock were made. The following is a summary of the most important facts:

As of November 30, 1937, petitioner Herbert R. Anderson owned 388 shares and the petitioner Ralph R. Anderson 360 shares of a total of 750 shares of the capital stock of Robert R. Anderson Company (R. 80), a company incorporated by petitioners' father in 1914 and engaged in the paving and heavy construction business (R. 80). All but 30 of these shares were either given by their parents to the petitioners (who first became stockholders at the ages of 13 and 9 respectively) or were given to their sister and later purchased by petitioners.

In 1937, or shortly before, petitioners decided to follow the family precedent of making gifts of stock in that company to members of their families (R. 35, 46).

A series of gifts of the stock of the company were made by petitioners to the members of their families in 1937, 1938, 1939 and 1940 (R. 35, 81, 82, 83). In each instance, the stock was transferred upon the books of the company, new stock certificates were issued in the names of the donees, and, with their knowledge and consent, were placed in a safe of the company, in care of the secretary of the company, who segregated the stock of each donee and held it for safekeeping (R. 81-83, 101).

In 1937, 1938 and 1939, dividends were paid upon the stock so donated, by checks issued to the donees, who, after discussion with petitioners, loaned the proceeds from the dividends to petitioners for their interest bearing notes, which were kept in the company's safe in care of its secretary (R. 36, 37, 38, 61, 67, 69, 71, 74, 81-84, 101). Some of the dividend checks were endorsed by petitioners

or by the secretary of the company in the names of the respective payees (R. 84), with their consent or approval (R. 37, 38, 64, 67, 69, 71).

In November, 1940, petitioners, their wives, and their children, after family discussion, concluded that it would be advisable to operate the family business as a partnership rather than as a corporation, and to avoid having minors as partners, it was agreed that the children would sell their stock at its fair market value to petitioners and their wives, for interest bearing notes. An understanding was reached that when the petitioners' sons became 25 years of age or finished school they could use the notes or their proceeds to purchase an interest in the partnership, and that the daughter of one of the petitioners should receive half of her money when she became 25 years of age or married and half when she became 30 years of age (R. 85-86, 101). The sale was carried out, the notes were executed and placed in the company's safe, in the care of its secretary (R. 57, 81, 86, 101). There was a partial distribution of assets in 1940, and the liquidation of the corporation was completed in 1941 (R. 86). Income taxes were paid by donors and donees on the basis of the validity of the gifts (R. 84, 86). No question concerning partnership income is involved (R. 7-33).

The Tax Court, in its opinion, stated that "The basic question involved here relates to the validity of the gifts which petitioners claim to have made to members of their families" (R. 87). The Tax Court held that "There were no bona fide gifts of stock by petitioners during 1937, 1938 and 1939" (R. 87). No mention was made by it concerning the 1940 gifts.

Subsequent to the decision of the Tax Court, the donees brought a proceeding against the petitioners in the Su-

perior Court of Cook County, Illinois, for a declaratory judgment to determine the question of the validity of the gifts and of the notes growing out of the gifts. An *amicus curiae* was appointed by the Court who participated in the arguments. The case was submitted upon the evidence taken before the Tax Court. The Commissioner was invited to intervene and participate and the decision of the Tax Court was considered by the state court. The decree of the latter court found that the gifts were valid and bona fide and made without limitation, reservation or secret understanding, that the dividends paid by the corporation to the respective donees were the sole and rightful property of the donees to whom paid, that the subsequent sales of the stock to the parents were valid, and that the notes above mentioned were valid and binding[1] (R. 105-111). The Tax Court refused to consider the decree of the Illinois Court (R. 118).

The Circuit Court of Appeals affirmed the decision of the Tax Court, but upon an entirely different ground. The Tax Court's decision was that bona fide gifts of stock had not been made by petitioners, and it considered and decided that issue upon the basis of the evidence before it (R. 79-89, 100-102), and refused to give any consideration whatever to the Illinois decree to the contrary (R. 118). The Circuit Court of Appeals did not consider the validity or invalidity of the gifts under state law. It concluded that Section 22 (a) "is not to be circumscribed

[1] It would have been difficult for the state court, consistently with Illinois authorities, to have come to any other conclusion than that the gifts were valid. Transfers to a wife or children are presumed to be gifts (Kartun v. Kartun, 347 Ill. 510, 518; Huston v. Smith, 248 Ill. 396, 405). A transfer of stock upon the corporate books is effective to transfer title and is sufficient evidence of donative intent(Chicago Title & Trust Co. v. Ward, 332 Ill. 126, 134). The Ward case is contrary to the conclusion of the Tax Court (R. 88) that the transfer of stock upon the corporate books is not sufficient to prove a gift.

by refinements of legal title or local law concepts of ownership"; "that command over property or enjoyment of its economic benefits marks the real owner for federal income tax purposes"; and "that mere passage of title to income-producing property through devices which are valid under state law will not insulate the transferor against federal income tax liability unless the passage of title is accompanied by a complete shift of the economic benefits of ownership, direct and indirect" (R. 143). The Court said that the evidence supported the Tax Court's findings, and "that the taxpayers remained the substantial owners of the stock transferred to their respective families" (R. 143).

The Tax Court's decision was based only upon the issue of the bona fides and the validity of the gifts. That Court did not consider or make any findings of fact upon the question as to whether petitioners, under Section 22 (a), could be taxed upon dividends or capital gains derived from the donated stock, even though the gifts were valid under state law, on account of the subsequent transactions of the petitioners concerning the donated stock, the dividends therefrom, and the notes given for their borrowings. The Circuit Court of Appeals considered the latter issue only. It was an issue first considered in that Court, and one which petitioners did not have the opportunity to meet in the Tax Court and to present in that Court whatever evidence they had bearing upon it.

Specification of Errors Relied upon.

We respectfully submit that the court below erred:

(1) In failing to reverse the decisions of the Tax Court of the United States;

(2) In refusing to consider and to follow the decree

of the Superior Court of Cook County, or alternatively, in not remanding the case to the Tax Court with instructions to consider and give effect to that decree;

(3) In holding that the petitioners were taxable on dividends paid upon and capital gains derived from stock of which the donees were the sole owners, under state law;

(4) In considering a new issue raised for the first time upon appeal, i.e., that even though the petitioners' gifts of stock were valid under state law, petitioners were still taxable upon the dividends paid upon and the capital gains derived from that stock as the "substantial owners" thereof under Section 22 (a) of the Internal Revenue Code, or alternatively, if that issue may be raised, in not remanding the case to the Tax Court for a hearing thereon.

Reasons Relied upon for Allowance of the Writs.

1. The decision of the Court below that the validity of the gifts under state law is not determinative for income tax purposes is in conflict with the decisions of the Circuit Court of Appeals for the Eighth Circuit, the Sixth Circuit, and the Second Circuit.

Eisenmenger v. *Commissioner*, 145 F. (2d) 103, C. C. A. 8th Cir., is a case in which the Tax Court had held certain debenture notes were income to the beneficiary of a trust. Subsequent to its decision, the question was submitted to a Minnesota court, upon the record and briefs in the Tax Court, and the state court reached a contrary conclusion. This decision was called to the Tax Court's attention. It granted a rehearing but adhered to its previous decision. Upon appeal to the Circuit Court of Appeals for the Eighth Circuit it was held that "The decision of the state court on the question of the ownership of this property was, we think, conclusive upon the tax court and upon

this court." (145 F. (2d) 106.) That case is opposed to the decision below on the questions of the binding effect of the state court decree upon ownership, and also upon the effect to be given to such a decree when entered after the decision of the Tax Court.[2]

In *Hubbell* v. *Helvering,* 70 F (2d) 568, 669, C.C.A. 8th Cir., it appeared that in a case involving income taxes of the same trust estate for earlier years it had been held that charges for depreciation and for the undepreciated cost of demolished or abandoned buildings were not required under the terms of the trust to be reserved or set aside by the trustees for those purposes, and therefore the amounts so reserved by the trustees were distributable income to the beneficiaries of the trust, and taxable to them as income under the then applicable revenue act. Later an Iowa state court entered a decree differently construing the terms of the trust. The question was whether the federal court was bound by the state court decree in a subsequent case concerning income taxes for later years. The Court ruled that it was, although "If it were open to us in this case to construe this trust agreement, we would see no reason to change the views and conclusions stated in the earlier case."

In *Helvering* v. *Rhodes' Estate,* 117 F. (2d) 509-510, C.C.A. 8th Cir., it was held that decrees of a Missouri court finding a decedent not to be the owner of certain corporate stock were binding upon the federal courts, although the question involved was one of fact rather than of law.

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[2] The court below ruled that there was no error in overruling petitioners' motion based on the state court decree, because the decree was entered subsequently to the order of the Tax Court (R. 143). In Vandenbark v. Owens-Illinois Glass Co., 311 U. S. 538, 543, it was held that "nisi prius and appellate tribunals alike should conform their orders to the state law as of the time of the entry." Under that case, as well as the Eisenmenger case, the court below should have given effect to the state court decree.

In *Nashville Trust Co.* v. *Commissioner,* 136 F. (2d) 148, 150, C. C. A. 6th Cir., it was held that the federal court was bound by a state court decree that certain services were not rendered gratuitously,—purely a question of fact.

In *Commissioner* v. *Merrell,* 93 F. (2d) 466, 468, C. C. A. 2nd Cir., the Court held that it was bound by a state court decree covering the character of the particular transaction under consideration, although it was a decision of a lower court and appeared to be contrary to the law laid down by the Court of Appeals of New York in another case.

2. The decision of the Court below is in conflict with applicable decisions of this Court.

Blair v. *Commissioner,* 300 U. S. 5, involved a gift by way of assignment of an interest under a trust. The federal court found that the assignment was invalid. Subsequently a state court held the assignment valid. The Circuit Court of Appeals refused to be bound by the state court decision and followed its own earlier decision on the question of the validity of the gift. The Supreme Court reversed, holding that the state court decree was binding for federal tax purposes, notwithstanding the earlier federal decision. *Freuler* v. *Helvering,* 291 U. S. 35, is to the same effect.

Sharp v. *Commissioner,* 303 U. S. 624, involved a question of Federal estate tax liability, which depended upon whether decedent or a trust which he had created, was the owner of certain property at the time of his death. This was a question of fact under the circumstances of the case. The Third Circuit Court of Appeals refused to follow a state court decree holding that the property belonged to the trust, and decided (91 F. (2d) 802, 803) that while the property might belong to the trust as a matter of state

law, that did not determine who was the owner for estate tax purposes. In a brief *per curiam* opinion, this Court reversed on the authority of the *Freuler* and *Blair* cases.

3. The decision of the Court below that the petitioners were the substantial owners of the donated stock (for the reason that the donees were amenable to the donors' suggestions because of affection and filial duty) is in conflict with decisions of the Circuit Court of Appeals for the Sixth Circuit, the Second Circuit and the First Circuit.

Marshall v. *Commissioner,* 57 F. (2d) 633, 634, C. C. A. 6th Cir., involved gifts of stock by a husband to his wife, transferred upon the books of the corporation. The Commissioner contended that because the wife testified that she depended upon and was guided wholly by her husband in financial transactions and would gladly return the securities to him if he ever wished or needed them, the husband had such control over the stock as to make him taxable upon the income therefrom. This contention was rejected by the Circuit Court of Appeals.

It was the same contention involved here,—that the donors remained the substantial owners of the stock for tax purposes, not because of any legal or equitable right in the stock retained by them, but because the donees were amenable to their suggestions and advice by reason of affection and filial duty, and the gifts therefore remained subject to their "control".

Richardson v. *Smith,* 102 F. (2d) 697, C. C. A. 2nd Cir., *Bardach* v. *Commissioner,* 90 F. (2d) 323, C. C. A. 6th Cir., and *Plimpton* v. *Commissioner,* 135 F. (2d) 482, C. C. A. 1st Cir., are in accord with the *Marshall* case and are in conflict on this issue with the decision of the court below.

Lawton v. *Commissioner,* 164 F. (2d) Adv. Sheets 380, C. C. A. 6th Cir., is similar in many respects to this case, except that no state court decree was involved. A husband gave to his wife and children stock in a closely in-

tegrated family enterprise. Certain "informalities" in handling business matters existed, and management decisions were "made at the family fireside, in which all of the family stockholders of the corporation participated." It was contended that the husband had never relinquished dominion and control of the gifts and remained the owner for tax purposes, but the Circuit Court of Appeals for the Sixth Circuit reversed the Tax Court's decision upholding that contention.

4. This case is distinguishable from *Helvering* v. *Clifford*, 309 U. S. 331, 337, cited and relied upon by the court below. That decision was based upon the *retention* by the creator of a trust of a substantial "bundle of rights" in respect of the trust property, including control of investments and of the principal, coupled with the circumstances of family relationship and the short duration of the trust.

But where there is an outright gift, valid under state law, as here, the donor does not retain any rights. The state court decree, relied upon by petitioners, found that the gifts were valid and were made "without any limitation, reservation or secret understanding whatsoever" (R. 107).

The court below held "that command over property or enjoyment of its economic benefits marks the real owner for federal income tax purposes" (R. 143). But that language assumes the existence of a *right* to such "command" or "enjoyment". Such a right is negatived by the finding of the state court decree above referred to. Whatever powers the donors exercised with respect to the subject matter of the gifts after they were made were exercised by them, not by virtue of the retention of any such powers, but by the consent of the donees.[3] The donees

[3] See the authorities cited under Point 3.

had the ownership of the stock, the right of command over it, and the right to enjoy the economic benefits of its ownership.

The donees, under state law and under the state court decree, were the owners of the stock from which the dividends and the gains here sought to be taxed were derived. There is no basis upon which the donees could escape taxation upon these items of income under Section 22(a), for that section expressly includes in "gross income" "gains * * * derived from * * * sales, or dealings in property", and also "dividends". As to such income "tax liability attaches to ownership" and ownership is determined by local law (*Blair* v. *Commissioner,* 300 U. S. 5, 12). See also *Poe* v. *Seaborn,* 282 U. S. 101, 109, and *Pearce* v. *Commissioner,* 315 U. S. 543, 554.

Only one tax is payable. Nothing in the statute gives to the Commissioner the right to choose which of them, the donors or the donees, should bear the tax.

This is but an application of the rule stated in *Helvering* v. *Stuart,* 317 U. S. 154, 161, that "Grantees under deeds, wills and trusts, alike, take according to the rule of the state law. * * * Once rights are obtained by local law, whatever they may be called, these rights are subject to the federal definition of taxability." The dividends and capital gains in question were received by the donees as the owners of the donated shares. The donees have been adjudicated by the state court to be the owners and entitled to those dividends and gains. Section 22 (a), as construed in the *Poe, Blair* and *Pearce* cases, requires the donees to include such dividends and gains in their income.

Partnership income is not involved here. Therefore, cases such as *Commissioner* v. *Tower,* 327 U. S. 280, also relied upon by the Court below have no application. That

case involved the taxation to the husband of partnership income in the case of a husband and wife partnership. The Court held that Section 22(a) "broadly includes" in taxable income "all earnings of any individual 'from any source whatever' " (pp. 282, 283). The Court recognized that the partnership might be valid under state law, but held that the real issue under Section 22 (a) was who "earned" the income which under Section 22 (a) was to be taxed to the one who earned it. The Court cited and applied the doctrine of *Lucas* v. *Earl,* 281 U. S. 111, and concluded that there was ample evidence to support the Tax Court's finding that the husband earned the income (p. 292).

Here no question of taxation of earned income is involved. The income sought to be taxed consists of dividends paid upon the donated stock and capital gains resulting from its sale or liquidation.

5. The decision below so far departs from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

The contention made by the Commissioner in the Circuit Court of Appeals and sustained by it, based upon the theory of substantial ownership for the purposes of Section 22 (a) of the Internal Revenue Code, regardless of the validity of the gifts under state law, is a complete departure from the theory and the issues upon which the case was tried in the Tax Court.

In its findings of fact the Tax Court after stating the evidentiary facts (R. 80-87) concluded: "There were no bona fide gifts of stock by petitioners during 1937, 1938 and 1939" (R. 87). The opinion of the Tax Court commences with the statement: "The basic question involved here relates to the validity of the gifts which petitioners

claim to have made to members of their families" (R. 87), and continues with a statement of the elements necessary to make the gifts valid and then proceeds to consider the application of the facts developed by the evidence to those elements, and ends with the statement: "Considering all the facts, in the light of the close family relationship existing here, we conclude that petitioners have not sustained their burden of proving the respondent in error in his determination" (R. 89). The Commissioner's determination was "that no valid gifts" of the stock "were effected" by the taxpayers and that they were the owners of the stock during the taxable years (R. 15, 16, 28, 29).

Nowhere is the Section 22 (a) theory referred to in the Tax Court's opinion or findings, or in the Commissioner's deficiency notices (R. 14-17, 27-31, 79-89, 100-102).

Determination of the facts is peculiarly and solely the function of the Tax Court (*Dobson* v. *Commissioner,* 320 U. S. 489, 502). The conclusion of the Circuit Court of Appeals that, notwithstanding the validity of the gifts under state law, petitioners were the substantial owners of the stock in question for tax purposes, in effect was a finding of fact made by that court and not one made by the Tax Court. In making such a finding of fact, the Circuit Court of Appeals usurped the function of the Tax Court without giving petitioners a hearing upon that question of fact.

A similar change of position on the part of the Commissioner was involved in *Hormel* v. *Helvering,* 312 U. S. 552, where the court said at page 560:

> "But the Board of Tax Appeals neither found the facts nor considered the applicability of § 22(a) in the light of the *Clifford* case. Congress has entrusted the Board with exclusive authority to determine disputed facts. Under these circumstances we do not feel

> that petitioner should be foreclosed from all opportunity to offer evidence before the Board on this issue, however remote may be his chance to take his case out of the Clifford rule."

Also see *Helvering* v. *Wood,* 309 U. S. 344, 348.

In these circumstances the Circuit Court of Appeals either should have refused to consider an issue not considered or passed upon by the Tax Court (*Hormel* v. *Helvering,* 312 U. S. 552, 556), or considering the case as an exceptional one authorizing deviation from customary practice, should have remanded the case to the Tax Court with liberty to the parties to offer evidence on the new issue, as was done in the *Hormel* case.

CONCLUSION.

It is respectfully submitted that this petition for writs of certiorari should be granted.

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April 5, 1948.

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In the Supreme Court of the United States

OCTOBER TERM, 1947

No. 725

RALPH R. ANDERSON, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

No. 726

HERBERT R. ANDERSON, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 79–89) is reported at 5 T. C. 443. The opinion of the Circuit Court of Appeals (R. 139–145) is reported at 164 F. 2d 870.[1]

[1] The cases were consolidated for hearing before the courts below. (R. 79, 127, 139.)

JURISDICTION

The judgments of the Circuit Court of Appeals were entered December 17, 1947. (R. 145–146.) Taxpayers' petition for rehearing was denied January 9, 1948. (R. 147.) The petition for writs of certiorari was filed April 8, 1948. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the court below erred in affirming the Tax Court's decision that taxpayers remained the substantial owners of shares of stock transferred of record to members of their families, and that the income from such shares was accordingly includible in taxpayers' gross incomes as defined in Section 22 (a) of the Internal Revenue Code.

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) *General definition.* — "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, divi-

dends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * * (26 U. S. C. 22.)

STATEMENT

The material facts found by the Tax Court (R. 80–87)[2] may be summarized as follows:

In 1937, taxpayers Herbert and Ralph Anderson, brothers, owned respectively 388 and 360, or a total of 748, of the 750 outstanding shares of stock of Robert R. Anderson Company. Herbert was married and had a son 14 years of age. Ralph had 3 children (14, 8, and 7 years of age) by his first wife, and remarried in 1939. (R. 80.)

On December 1, 1937, taxpayers through simultaneous transfers caused some of their shares to be transferred on the corporate books to members of their families. As a result, Herbert's wife and child became record owners of a total of 68 shares, corresponding to the number transferred by him; while Ralph's children became the record owners of a total of 85 shares, corresponding to the number transferred by him. The new certificates were placed in a safe of the company in the care of one Christiansen, the secretary of the company, with the knowledge and consent of the

[2] The Tax Court's findings were amended by its order (R. 100–102) entered upon taxpayers' Motion for Rehearing and Reconsideration (R. 91–100). The statement incorporates these amendments.

donees, who were fully apprised of the transfers. Christiansen placed the certificates in envelopes bearing the names of the donees. Ten days after the transfer a dividend of $25 per share was declared on the stock, and on the same day taxpayers borrowed the dividends from the transferees and executed in exchange 6% demand notes which were also kept in the office of the company. (R. 81–82, 101.)

On April 1, 1938, taxpayers caused more of their shares to be similarly transferred on the corporate books and the new certificates to be placed with the others. As a result, the record ownership of Herbert's wife and child was increased to a total of 140 shares, corresponding to the total number transferred by him; while the record ownership of Ralph's children was increased to a total of 175 shares, corresponding to the total number transferred by him. (R. 82.) A few days later another dividend of $25 per share was declared, which taxpayers again borrowed from the transferees in exchange for 6% demand notes which were placed in the company safe. (R. 82–83.)

On April 15, 1939, taxpayers caused additional shares to be similarly transferred and the new certificates to be placed in the company safe with the others. The record ownership of Herbert's wife and child was thereby increased to a total of 228 shares, corresponding to the total number theretofore transferred by him; while the record

ownership of Ralph's children and second wife was increased to a total of 307 shares, corresponding to the total number theretofore transferred by him. (R. 83.) Two weeks later a dividend of $50 per share was declared, taxpayers again borrowed the dividends from the transferees, and again executed 6% demand notes which were placed in the company safe. (R. 83–84.)

No interest was paid on any of the notes given for the borrowed dividends. On December 31, 1941, taxpayers each executed new 6% demand notes for the amount of interest then due. Each taxpayer devoted the dividends he borrowed to his own business or personal use, though not for the support or maintenance of his wife or children. Some of the dividend checks were endorsed by taxpayers or by Christiansen in the names of the payees. (R. 84.)

After the transfers taxpayers continued to manage and direct the affairs of the corporation in the same manner as before. No formal stockholders' meetings were held after the transfers until November 9, 1940. (R. 85).

In 1940 taxpayers decided to convert the business from a corporation to a partnership. With the consent of all the members of the family it was arranged that taxpayers and their wives would acquire the stock standing in the names of the children in such proportions that each would own one-fourth of the stock, in exchange for notes to the children. Accordingly, on No-

vember 19, 1940, transfers were made on the corporate books placing the entire outstanding stock in the names of taxpayers and their wives in equal amounts of 187½ shares each, and taxpayers and their wives executed 6% demand notes to the children in amounts based on the book value of the shares. These notes were likewise placed in the company safe. It was understood that when the sons reached 25 or finished school they could use the notes or proceeds to purchase an interest in the partnership, while the daughter would receive one-half of the amount of her note when she reached 25 or married and the other half when she reached 30. A partial liquidation distribution was made before the end of 1940, and the liquidation was completed in 1941. On December 31, 1941, additional notes were given to the children in the amounts of the unpaid interest and were placed in the safe with the others. At the same time taxpayers took credits against the principal of the notes for income tax payments and investments made on behalf of the children, these credits being acknowledged in most instances by appropriate endorsement on the notes. (R. 85–86, 101.)

In 1941 taxpayers decided to create trusts for the children, the corpora to consist of the various notes which had been executed and were still in the company safe. They caused a trust agreement to be prepared, naming their brother-in-law as trustee, and instructed Christiansen to destroy

the old notes and substitute new ones payable to the trustee. The new notes were prepared, but the old ones were never destroyed. The trust agreement was executed January 2, 1942, but when the trustee later inquired about payment of interest on the new notes he was informed that the trust agreement was void and would be cancelled on the advice of taxpayers' attorney. The trust agreement was marked "void" and returned to taxpayers with the new notes. (R. 87.)

The dividends on the transferred shares were reported as the income of the wives and children. The taxes were paid on their behalf by taxpayers. (R. 84, 89.) The Commissioner determined that the transfers were without federal income tax effect and included in taxpayers' gross incomes for 1939 the dividends paid in that year on the transferred shares, resulting in the 1939 deficiencies in controversy. (R. 15, 28.) The Commissioner likewise disregarded the transfers in determining the capital gain realized by taxpayers upon the 1940 liquidation distribution, and included in their gross incomes for that year the gain attributable to the number of shares orginally held by them, resulting in the 1940 deficencies in controversy. (R. 16, 29.) The Tax Court concluded that the alleged gifts were not bona fide (R. 87), that taxpayers did not intend to relinquish dominion and control over the trans-

ferred shares (R. 88, 89), and sustained the Commissioner's deficiency determinations (R. 90).

After the Tax Court's opinion was promulgated, and on August 17, 1945, taxpayers filed a "Motion for Rehearing and Reconsideration." (R. 91–100.) This motion was granted insofar as it requested modifications in certain particulars of the Tax Court's findings of fact and in all other respects was denied. (R. 100–102.) Thereafter, on November 19, 1945, taxpayers filed a "Motion for Special Leave To File Motion for Further Hearing and Reconsideration" (R. 102–117), which was denied (R. 118).

The Circuit Court of Appeals affirmed (R. 139–145), and taxpayers' petition for rehearing was denied (R. 147).

ARGUMENT

1. The decision below is in accord with the established principle that a donor who retains command or other economic benefits of ownership of the donated property remains its real owner for purposes of Section 22 (a) of the Internal Revenue Code, *supra*. *Commissioner* v. *Sunnen*, No. 227, decided by this Court April 5, 1948, not yet reported; *Commissioner* v. *Tower*, 327 U. S. 280; *Helvering* v. *Clifford*, 309 U. S. 331; *Corliss* v. *Bowers*, 281 U. S. 376. It is immaterial whether the gift is made in trust (*Helvering* v. *Clifford, supra; Corliss* v. *Bowers, supra*) or, as in this case, directly to the donee (*Commis-*

sioner v. *Sunnen, supra; Commissioner* v. *Tower, supra; Gouldman* v. *Commissioner,* 165 F. 2d 686 (C. C. A. 4th); *Overton* v. *Commissioner,* 162 F. 2d 155 (C. C. A. 2d); *Coffey* v. *Commissioner,* 141 F. 2d 204 (C. C. A. 5th)). Nothing in the controlling decisions warrants the view, upon which the petition for certiorari is founded, that the broad definition of gross income contained in Section 22 (a) is to be circumscribed by refinements of legal title or by local law concepts of ownership; in that section Congress exercised to the full measure its constitutional power to tax income. *Helvering* v. *Clifford, supra,* p. 334; *Helvering* v. *Stuart,* 317 U. S. 154, 169; *Douglas* v. *Willcuts,* 296 U. S. 1, 9; *Irwin* v. *Gavit,* 268 U. S. 161, 166. Indeed where, as here, we are dealing with intra-family transfers, "special scrutiny of the arrangement is necessary lest what is in reality but one economic unit be multiplied into two or more by devices which, though valid under state law, are not conclusive so far as § 22 (a) is concerned." *Helvering* v. *Clifford, supra,* p. 335. See also *Commissioner* v. *Tower, supra,* pp. 287–288.

The record unquestionably justifies the Tax Court's conclusion (R. 87, 88–89), sustaining the Commissioner's determination, that taxpayers remained the substantial owners during the taxable years of the portions of the stock holdings which they purported, by a series of simultaneous criss-cross transfers, to give to their respective wives

and children. The stock certificates were never delivered to the donees; although taxpayers purported to transfer most of their stock interest they continued, as before, to exercise all the rights of controlling stockholders; shortly after each transfer they caused the corporation to declare substantial dividends which they immediately "borrowed" from the donees and appropriated to their own use; demand notes executed by them for the borrowed dividends were never delivered to the donees, and neither interest nor principal on these notes was ever paid; the shares placed in the children's names were later reacquired for the purpose of liquidating the corporation and enabling taxpayers to form a partnership with their wives; demand notes executed for the reacquired shares, like those executed for the dividends, were not delivered and remained unpaid; taxpayers later ordered destruction of all the notes and substitution of others payable to a trustee, and then countermanded this order on advice of their attorney. (R. 80–87.) Any one of the foregoing features—which are uncontroverted—furnishes solid evidentiary support for the Tax Court's inference that the gifts were not "bona fide" (R. 87) and that taxpayers did not intend to "relinquish dominion and control" over the donated shares (R. 88). When they are viewed in combination the evidentiary basis for the Tax Court's conclusion is unassailable. Under familiar rules governing the scope of judicial

review of Tax Court decisions, affirmance of the Tax Court's decision by the court below was clearly correct. To permit the tax consequences here to turn upon the paper maneuvers employed by taxpayers would sanction a type of formalism which the courts have repeatedly refused to recognize as effectual to alter tax liability.[3]

2. The decision below is not in conflict with applicable decisions of this Court or of any of the Circuit Courts of Appeals. Taxpayers' reliance (Pet. 11–12) upon *Blair* v. *Commissioner*, 300 U. S. 5; *Freuler* v. *Helvering*, 291 U. S. 35; and *Sharp* v. *Commissioner*, 303 U. S. 624, is misplaced. These cases furnish no authority whatever for their assumption that the validity of a gift under state law precludes taxability of the donor under Section 22 (a).[4] They presented

[3] This case is a much stronger one than the *Clifford* case for treating the donor as substantial owner for purposes of Section 22 (a). In that case it was stipulated (p. 333) that the income from the donated stock was used by the donee-wife for the benefit of herself and the children; taxpayers here continued to enjoy use of the income (as well as control over the income-producing stock) by "borrowing" the dividends (R. 81–84) and applying them to their own use (R. 84, 89). What is more, taxpayers did not even purport to act in a fiduciary capacity in exercising control over the donated stock, as did the donor in the *Clifford* case.

[4] The "state law" upon which taxpayers rely (Pet. 2–3, 8, 9) consists of a declaratory judgment by the Superior Court of Cook County, Illinois, obtained in proceedings commenced after the Tax Court's opinion was promulgated (R. 102, 113). Four months after the filing of the opinion taxpayers filed a "Motion for Special Leave" (R. 102–117) to reopen the proceedings on the basis of the state court decree.

situations in which a settlor had parted with substantial (as well as titular) ownership of a trust fund, and arose under the statutory provisions dealing with the taxability of trust income to the trustee vis-a-vis the beneficiaries.[5] They turned upon local law merely for purposes of construction of the trust instrument. Thus in the *Blair* case local law was held (pp. 10–11) determinative of the power of the beneficiary to assign his interest; in the *Freuler* case it was held (pp. 43–45) determinative of the distributive rights of the beneficiaries; and the *Sharp* case, involving the question whether certain property belonged to a decedent's estate or a trust created by him, was decided *per curiam* on the basis of the *Blair* and

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No reason appears why the proceedings could not have been instituted and the decree obtained "in ample time to present it before the Board [now the Tax Court] had made and filed its findings of fact and opinion." *Bankers Coal Co.* v. *Burnet*, 287 U. S. 308, 313. At any rate, even if the state court decree had antedated the Tax Court's opinion, it would not have been controlling for federal income tax purposes. *Doll* v. *Commissioner*, 149 F. 2d 239 (C. C. A. 8th), certiorari denied, 326 U. S. 725; *Sewell* v. *Commissioner*, 151 F. 2d 765 (C. C. A. 5th), certiorari denied, 327 U. S. 783); *Loggie* v. *Thomas*, 152 F. 2d 636 (C. C. A. 5th); *Eisenberg* v. *Commissioner*, 161 F. 2d 506 (C. C. A. 3d), certiorari denied, 332 U. S. 767.

[5] Sections 161 and 162 of the Internal Revenue Code (26 U. S. C. 161, 162), and corresponding sections of the prior Revenue Acts. "These provisions have appropriate reference to cases where the income of the trust is no longer to be regarded as that of the settlor." *Douglas* v. *Willcuts*, *supra*, p. 10. See also *Harrison* v. *Schaffner*, 312 U. S. 579.

Freuler decisions.[6] The Circuit Courts of Appeals cases upon which taxpayers chiefly rely for conflict (Pet. 9–10) are of the same nature and involved issues equally far removed from that here presented.

As for the cases relied upon by taxpayers (Pet. 12–13) which do deal with the question here presented, they turn as they must on their own facts and present no conflict. *Marshall* v. *Commissioner*, 57 F. 2d 633, certiorari denied, 287 U. S. 621, and *Bardach* v. *Commissioner*, 90 F. 2d 323, decided by the Circuit Court of Appeals for the Sixth Circuit, antedated the *Clifford* and related cases, and are to be contrasted with later decisions of the same court in cases bearing a closer factual resemblance to the one at hand.[7] *Lawton* v. *Com-*

[6] In *Helvering* v. *Stuart*, *supra*, pp. 161–162, this Court cited the *Blair* and *Freuler* cases for the proposition that "The power to transfer or distribute assets of a trust is essentially a matter of local law," and proceeded to observe (p. 162) that "Once rights are obtained by local law, whatever they may be called, these rights are subject to the federal definition of taxability." Far from departing from the familiar doctrine that command over property or its income marks the owner for purposes of Section 22 (a), this Court (p. 169) remanded the *John Stuart* case to the Tax Court for the purpose of determining whether the taxpayer-grantor remained the substantial owner under the principles enunciated in the *Clifford* case.

[7] See, *e. g.*, *Dawson* v. *Commissioner*, 163 F. 2d 664 (C. C. A. 6th); *Lowry* v. *Commissioner*, 154 F. 2d 448 (C. C. A. 6th), certiorari denied, 329 U. S. 725; *Miller* v. *Commissioner*, 147 F. 2d 189 (C. C. A. 6th). In *Seifert* v. *Commissioner*, 157 F. 2d 719 (C. C. A. 2d), the court expressly refused to con-

missioner, 164 F. 2d 380, decided by the same court, is patently distinguishable on its facts. *Plimpton* v. *Commissioner,* 135 F. 2d 482 (C. C. A. 1st), was distinguished by the very court which decided it in *Emery* v. *Commissioner,* 156 F. 2d 728, 731–732, certiorari denied, 329 U. S. 772, on grounds which also distinguish it from this case. And *Richardson* v. *Smith,* 102 F. 2d 697 (C. C. A. 2d), confirms rather than impugns the correctness of the decision below.

CONCLUSION

The decision below is correct. There is no conflict, and no occasion for further review. The petition should therefore be denied.

Respectfully submitted.

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APRIL, 1948.

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sider the *Marshall* case as authority on the tax effect of intra-family gifts.

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